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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 679

BARROW MANUFACTURING COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 103–132)[1] are not officially reported. The opinion of the Court of Appeals (Pet. 16–23) is reported at 294 F. 2d 79.

JURISDICTION

The judgment of the Court of Appeals was entered on August 24, 1961. (Pet. 23.) An application for an extension of time within which to file a petition for certiorari was filed on November 22, 1961. On November 24, 1961, an order was entered by Mr. Justice Black extending the time to and including January 21, 1962, a Sunday. The petition for a writ

[1] Record references are to the transcript of record in the Court of Appeals.

of certiorari was filed on January 22, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's finding that the taxpayer-corporation permitted its earnings to accumulate beyond its reasonable needs for the purpose of avoiding surtax on its shareholders and therefore was liable for the surtax imposed by Section 102 of the Internal Revenue Code of 1939.

STATUTES INVOLVED

Section 102 of the Internal Revenue Code of 1939 and Section 534 of the Internal Revenue Code of 1954 are set out in pertinent part in the Appendix, *infra*.

STATEMENT

The taxpayer is a Georgia corporation engaged in the garment manufacturing business, primarily producing sportswear, work clothing, pants and shirts for wholesale trade. The corporation was chartered in 1931 with a capital stock of $10,000, and from the charter date through the taxable years in question it experienced steady growth. In fiscal year 1932, sales were approximately $61,000. In fiscal year 1953, sales had risen to approximately $2,165,000. During the years through 1953, profits after taxes averaged approximately 5% of sales. Dividends averaged less than 10% of profits after taxes, and consequently, the earned surplus increased from $1,924.76 in 1932 to $726,718.01 in 1953 (R. 103, 105, 108, 128; Pet. 17–18.)

For the fiscal years 1951, 1952, and 1953, profits

after taxes totalled $182,440.33. The taxpayer distributed $13,500 in dividends to its shareholders. If all the earnings and profits had been distributed to the shareholders, an additional tax liability of $86,775.86 would have been incurred by them (R. 122, 125).

Taxpayer's need for operating funds was minimized by a rapid turnover of inventory and prompt collection of accounts receivable (R. 109–121; Pet. 21). From November 1946, through the years in question, taxpayer kept $50,000 invested in United States Savings Bonds, and from February 1949 through these years, it kept $100,000 invested in twenty different Federal Savings and Loan Associations. The taxpayer urged that these investments were intended primarily to accumulate a fund for construction of a new factory building, but during the years in question and as late as April 1959 the project was vague and generalized, and the taxpayer had taken no substantial active move toward implementation (R. 121, 126; Pet. 18–20).

The Tax Court found that during the fiscal years 1951, 1952 and 1953, the taxpayer-corporation's earnings were accumulated beyond the reasonable needs of its business for the purpose of preventing the imposition of the surtax on its shareholders (R. 122, 123–131). The Court of Appeals affirmed (Pet. 16–23).

ARGUMENT

The decision below is correct and there is no conflict of decisions or other reason for further review of the case by this Court. During the last two terms this Court has declined to review four other cases

involving the same issue and similar factual situations. *I. A. Dress Co.* v. *Commissioner*, 273 F. 2d 543 (C.A. 2d), certiorari denied, 362 U.S. 976; *Smoot Sand & Gravel Corp.* v. *Commissioner*, 274 F. 2d 495 (C.A. 4th), certiorari denied, 362 U.S. 976; *Dixie, Inc.* v. *Commissioner*, 277 F. 2d 526 (C.A. 2d), certiorari denied, 364 U.S. 827; *Raymond I. Smith, Inc.* v. *Commissioner*, 292 F. 2d 470 (C.A. 9th), certiorari denied, December 18, 1961, No. 524, this Term.

1. The case involves the application of Section 102 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 8), which imposes a surtax upon a corporate taxpayer if it is availed of for the purpose of avoiding the imposition of surtax upon its shareholders by permitting earnings to accumulate instead of distributing them to its shareholders. An accumulation of earnings beyond the reasonable needs of the business is expressly made sufficient to establish liability for the corporate surtax unless the corporation by the clear preponderance of the evidence shall disprove the purpose to avoid shareholder surtax. (Section 102(c)). Whether an accumulation is excessive (and therefore whether the corporation is presumed to have been availed of for the proscribed purpose) is a question of fact, and the trial court's findings are conclusive if supported by the evidence. *Helvering* v. *Stock Yards Co.*, 318 U.S. 693, 701–702; *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 295, rehearing denied, 305 U.S. 669.

Here the Tax Court, on the basis of undisputed subsidiary findings, found that the taxpayer permitted its earnings in each of the years in question to ac-

cumulate beyond the reasonable needs of the business. (R. 130.) The court of appeals affirmed. The conclusion concurred in by the two lower courts is entitled to finality in the absence of a very exceptional showing of error. *Corn Products Co. v. Commissioner*, 350 U.S. 46, 51; *Comstock v. Group of Investors*, 335 U.S. 211, 214.

2. Taxpayer contends that the courts below misapplied Section 534 of the 1954 Code. That section, which is retroactive to the years involved here, provides that, if the taxpayer files a statement of the grounds on which he relies to explain an accumulation of earnings, the burden of proof as to those grounds will be shifted to the Commissioner. The Tax Court did not affirmatively rule on the sufficiency of the taxpayer's statement for that purpose. It did, however, give taxpayer the full benefit of Section 534 by expressly assuming, for purposes of decision, that the statement was sufficient and that the burden of proof was therefore on the Commissioner (R. 130; Pet. 21–22). Even on that assumption, the courts below held, the record facts affirmatively substantiated the Commissioner's contention and required a finding that the taxpayer's earnings were accumulated beyond the reasonable needs of its business (Pet. 22). That finding, not itself challenged here and made on an assumption giving the taxpayer the full benefit of Section 534, is dispositive of this case.

3. The decision below is not, as taxpayer contends, in conflict with that of the Second Circuit in *R. Gsell & Co. v. Commissioner*, 294 F. 2d 321. In that case, the Tax Court had held that the evidence required a

finding of unreasonable accumulations even assuming that the burden of proof was on the Commissioner and therefore found it unnecessary to decide the sufficiency of the Section 534 statement. The court of appeals reversed the finding as being clearly erroneous and held that, if the burden of proof was in fact on the Commissioner, the evidence was insufficient to satisfy it. That holding made the burden-of-proof issue dispositive, and the court of appeals proceeded, accordingly, to resolve it, finding the taxpayer's statement sufficient to have shifted the burden to the Commissioner. All the case holds, therefore, is that the burden-of-proof issue must be decided if the outcome turns upon it; that holding does not conflict with the decision below that the issue need not be decided where the Tax Court correctly concluded that the result would be the same whichever party had been burden of proof.

There is similarly no conflict with the decision of the Second Circuit in *Casey* v. *Commissioner*, 267 F. 2d 26 (Pet. 12), where under the particular facts the court held that the Commissioner had failed to sus-

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[1] There is a statement in the Second Circuit's opinion that "in close cases the determination of who has the burden of proof on the unreasonable accumulations issue must be resolved" (294 F. 2d at 326), but by a "close case" the court seems to have meant one in which the burden-of-proof issue is, as it later said in the same paragraph, "crucial"—*i.e.*, one in which there is insufficient evidence to satisfy the burden if it is on the Commissioner, so that the outcome of the case depends upon the placement of the burden of proof. In any event, anything more that might be inferred from the statement is mere dictum, since the court held that, in that case, the evidence was in fact insufficient to meet the Commissioner's burden, thus making the burden-of-proof question dispositive.

tain the burden imposed by Section 534 of the 1954 Code of proving that taxpayer there had unreasonably accumulated profits. *Young Motor Co.* v. *Commissioner,* 281 F. 2d 488 (C.A. 1st) (Pet. 13), likewise turned upon the particular facts and presents no conflict with the holding of the court below as to the meaning of Section 534.

CONCLUSION

The decision below is correct and no conflict or question of public importance is presented. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1962.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

(a) [As amended by Sec. 103(d), Revenue Act of 1941, c. 412, 55 Stat. 687] *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P), if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

38½ per centum of the undistributed section 102 net income in excess of $100,000.

* * * * *

(c) *Evidence Determinative of Purpose.*—The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary.

* * * * *

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 534. BURDEN OF PROOF.

(a) *General Rule.*—In any proceeding before the Tax Court involving a notice of the deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) [As amended by Sec. 5, Act of August 11, 1955, c. 805, 69 Stat. 689] *Notification by Secretary.*—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531. In the case of a notice of deficiency to which subsection (c)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) *Statement by Taxpayer.*—Within such time (but not less than 30 days) after the mailing of the notification described in subsection (b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which

the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

* * * * *

(c) [As amended by Sec. 4, Act of August 11, 1955, *supra*]. *Application of Section.*—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.